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IN THE

Supreme Court of the United States

October Term, 1953

No. 537

MARY YOUNG MOORE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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IN THE

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MARY YOUNG MOORE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

The petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above entitled cause on September 21, 1953, reversing the decision of the Tax Court of the United States, reported at 15 Tax Court 906. A Petition for Rehearing was filed in the United States Court of Appeals for the Ninth Circuit on October 20, 1953, and was denied on November 5, 1953.

Opinions Below.

The Tax Court of the United States rendered a written opinion, reported at 15 Tax Court 906, finding that petitioner was entitled to take depreciation deductions on an inherited half interest in the Barker Bros. Building, on a value, as of November 3, 1938, of $800,000.00, said building having a remaining useful life, after that date,

of thirty-seven years and two months. [Tr. 59-71.] The opinion of the United States Court of Appeals for the Ninth Circuit, reversing the Tax Court's decision on the above point, is reported at 207 F. 2d 265. [Tr. 343-372.]

Jurisdiction.

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on September 21, 1953. [Tr. 373.] A Petition for Rehearing was filed on October 20, 1953, and was denied on November 5, 1953. [Tr. 374.] The jurisdiction of this Court is invoked under 28 United States Code, Section 1254(1) as amended September 1, 1948.

Questions Presented.

Whether an inheritor of real property is entitled to a deduction for Federal income tax purposes, of depreciation of a building existing on said property at the time of the devisor's death, which building was erected prior thereto by a lessee of the devisor.

The following subsidiary questions are involved:

1. Did the lower court err in holding that the building had no value, subject to the lease, where the Tax Court made no finding and there was no testimony on this point and witnesses for both parties testified that the building had a large value at the date of death of petitioner's devisor, that they knew of the existence of the lease, and the lease could be abandoned by the lessee before the end of the useful life of the building?

2. If petitioner had an amortizable interest in the lease, should the period of amortization run to the termination of the lease as held by the court below, or should

it run only for the duration of the useful life of the building or some other period?

3. If the only amortizable interest petitioner had was in the lease, should the Tax Court be free to determine that petitioner has no basis for said lease, and, therefore, has nothing to amortize, or should it be required to find that there is a minimum basis for the lease of the difference between the stipulated value of petitioner's entire inherited interest of $1,533,100.00 and the highest value placed by any expert testimony in the record as to the value of the land alone on the date of the devisor's death?

Statutes and Regulations Involved

The statutes and regulations involved will be found in the Appendix hereto, pages 21 to 24, inclusive.

Statement.

Petitioner and her mother, Mrs. Mary C. Young, were the equal owners of a parcel of land situated on Seventh Street, between Flower and Figueroa Streets, Los Angeles, California. [Tr. 41, par. 3.] On October 1, 1924, they executed a 99 year lease to Sun Realty Company. [Tr. 41.] The lease required the lessee to demolish a building then on the premises, and to construct, at its own expense, a new building thereon to cost not less than $2,000,000.00. The rental was to be $20,000.00 per month after the building was completed. [Ex. 1-A, par. 2.] The lessee agreed to pay all taxes and other levies and charges on the property. The lease contemplated the making of a sublease to Barker Bros. Corporation and such a sublease for a term of 35 years was executed with the approval of the original lessors on October 30,

1924. [Ex. 1-A, p. 17, par. 13.] The building called for in the original lease was completed January 1, 1926, at a cost of $2,132,000.00. [Tr. 42, par. 5.] The lease provided that the building would at all times belong to the lessors. [Ex. 1-A, p. 18, par. 14.]

Petitioner's mother died November 3, 1938, and by Will left her half interest in the property to her daughter, the petitioner herein. [Tr. 39-40, par. 2.] Petitioner, as Executrix, filed a Federal Estate Tax Return, and by compromise with the Commissioner of Internal Revenue, the value of the estate's half interest in the property was fixed at $1,533,100.00, and Federal estate tax was paid thereon. The estate tax proceedings made no segregation or intemization of the elements considered in making up that valuation. [Tr. 42-43.]

The parties hereto have stipulated that as of November 3, 1938, the total value of the property which petitioner inherited from her mother was $1,533,100.00. [Tr. 42, 54, par. 6.]

Expert witnesses for the taxpayer gave their opinions as to the value of the half interest in the land, the building and the lease, as of November 3, 1938. Their values were as follows:

	Basic Value	Increase in Basic Value Due to Lease	Values After Allocation of Lease Value
Land	$ 400,000.00	$109,931.00	$ 509,931.00
Building	803,307.00	219,862.00	1,023.169.00
Lease	329,792.00	.....	.....
	$1,533,100.00	$329,793.00	$1,533,100.00

[Tr. 113, 114, 115, 116, 202, 203, 204.]

The Commissioner's expert witnesses testified that they were familiar with the lease, and took its provisions into account in valuing the land and building, and gave values of the one-half interest, as of November 3, 1938, as follows:

	Allen	Frisbie
Land	$ 660,000.00	$ 750,000.00
Building	873,100.00	783,100.00
	$1,533,100.00	$1,533,100.00
	[Tr. 265, 266.]	[Tr. 305, 306.]

The Commissioner's witness, Frisbie, testified that the lease called for three or four times as much rent per square foot of land as was being paid in the vicinity [Tr. 306] on November 3, 1938, and that the land, without the lease, would have been worth but $375,000.00. [Tr. 318.] His witness, Allen, in placing a value of $660,000.00 on the land, said he determined that value largely by the lease. [Tr. 266.]

The Tax Court found that the inherited half interest in the building was worth on November 3, 1938, $800,000.00, and that the building had a useful life, from November 3, 1938, of thirty-seven years and two months and allowed petitioner depreciation deductions based on those findings. [Tr. 62, 63, 71.]

The United States Court of Appeals for the Ninth Circuit in the opinion below held that petitioner was not entitled to any depreciation with respect to the building but might be entitled to some amortization of the lease itself.

Petitioner contends that she became the owner of the building as of November 3, 1938; that she thereafter held it for the production of income; that it had a value of $800,000.00 on that date; that this is the value that is to be taken into consideration in determining her depreciation deductions under Section 113(a)(5) of the Internal Revenue Code; and that her interest in the building will depreciate to zero by December 31, 1975.

Reasons for Granting the Writ.

1. The instant case involves an important question of Federal income tax law of general application which, in view of the present confused state of the law on the subject, should be settled by this Court.

In a great many of the long term leases entered into in this country, the lessee has erected a building which, by the provisions of the lease or local law, belongs immediately to the lessor, with possession in the lessee. In many of those instances, the lessors have been individuals, who upon death, devise the property to heirs. When a Federal estate tax is paid on the estate of the devisor and the heirs thereby acquire a basis for gain or loss and depreciation under Section 113(a)(5) of the Internal Revenue Code, there is presented the question as to whether the heir is entitled to take depreciation deductions on the value of the building. Furtherfore, the same issue is involved when a third party purchases such a lessor's interest.

The Tax Court first considered this problem in the case of an heir in *Charles B. Currier,* 7 T. C. 980. It there allowed the heir to take depreciation on the improvements erected on the premises by the lessee of the

heir's devisor. The Commissioner of Internal Revenue acquiesced in this decision, 1947-1 C. B. 2, and, therefore, did not appeal from it. However, in 1950, he withdrew his acquiescence and filed a non-acquiescence, 1950-2 C. B. 5.

The *Currier* case was followed in two subsequent decisions of the Tax Court, both allowing the heir under such circumstances to take depreciation on the improvements: *Helen B. Pearson,* 13 T. C. 851, and the Tax Court decision in the instant case. Upon appeal to the Court of Appeals for the Fifth Circuit, the *Pearson* case was reversed: *Commissioner of Internal Revenue v. Pearson,* 188 F. 2d 72 (C. C. A. 5th), cert. den. 342 U. S. 861. In that appeal, the Fifth Circuit denied the heir a depreciation deduction on the building because of a failure of proof that the value of the inherited interest for estate tax purposes exceeded the value of the land. However, the Fifth Circuit indicated that, under other circumstances, such as those in the instant case, the heir would be entitled to the deduction, saying at page 74:

> "We agree with the general view of the Tax Court that there is no necessary inconsistency in the holding that, though an ancestor, lessor, having no cost basis, does not have a depreciable interest in a building erected by a lessee, an heir may, as an incidence of estate taxation, and, under Sec. 113(a)(5) 15 I. R. C., have a basis for depreciation and an interest to depreciate."

In contrast, the view of the court below in the instant case is that the heir can never obtain a depreciable interest in the building, since the heir's interest is only the right to occupy it at the termination of the lease, which

is worth zero both at the time of the devisor's death and at the time of the termination of the lease.

The only other case directly in point on the instant question is *First National Bank of Kansas City v. Nee,* 190 F. 2d 61 (C. C. A. 8th), which, under facts substantially different from those in the instant case, also denied the heir depreciation on improvements, but on a theory different from both that of the Fifth Circuit in the *Pearson* case and of the Ninth Circuit in the instant case.

It is certain that there are a great number of cases pending in the Tax Court and the District Courts of the United States involving this issue, either as it applies to an heir or a purchaser from the lessor. In view of the present confused state of the law on this problem, such heirs and purchasers will of necessity litigate with the Commissioner of Internal Revenue their right to a depreciation deduction until this Court has finally settled the question.

A similar situation existed several years ago when taxpayers and the Commissioner of Internal Revenue litigated the question of whether or not a lessor realized taxable income when, pursuant to a lease, a lessee erected an improvement on the premises which was to become the property of the lessor at the end of the lease, and the further question of whether or not said improvement became taxable income to the lessor upon the termination of the lease. It was ultimately necessary for this Court to settle both issues.

Blatt v. United States, 305 U. S. 267;
Helvering v. Brunn, 309 U. S. 461.

2. The decision of the court below, that only the value of the building as of the end of the lease is to be considered, is in conflict with the decision of this Court in *Crane v. Commissioner,* 331 U. S. 1. In that case, Mrs. Crane inherited from her husband an apartment house which was worth on the date of his death $262,000.00. It was encumbered by a mortgage in the amount of $262,000.00, so that his wife received an equity of zero. Several years after her husband's death, she sold her interest in the property for $2,500.00, net, and reported the same as a capital gain, showing a taxable income of $1,250.00 on which she paid tax. The Commissioner of Internal Revenue argued that she had inherited the gross building and was entitled to depreciation deductions at 2% per annum on a value of $207,000.00 (the proportion of the $262,000.00 allocation to the building) which was the gross value of the building at date of death. The Commissioner contended that the total allowable depreciation of $28,000.00 should be added to the $2,500.00, so that the total gain would be $30,500.00. Mrs. Crane contended that she had inherited the equity only, and that it was zero, and, therefore, she had no basis for depreciation and no allowable depreciation should be added to her $2,500.00 sale price. This Court determined that the word "property" used in Section 113(a)(5) of the Internal Revenue Code (which is the same section involved in the case at bar) meant the gross value of the property and not that value reduced by the mortgage.

The decision of the lower court in the case at bar was that the value to be considered, under Section 113(a)(5), as the basis for depreciation of the building, was not the gross value of the building at the date of the devisor's death, but that value diminished to zero, due to the fact

that possession of the building was in the lessee, and was to be in the lessee throughout the life of the building.

This decision seems to be in direct conflict with the decision of this Court in the *Crane* case. The lower court's attempted distinction of the *Crane* case, was on the ground that in that case one party only (the mortgagor) could claim depreciation deductions, while in the case at bar the lower court said the lessee was entitled to depreciation deductions, and the lessor (petitioner herein), was also claiming depreciation deductions.

In the *Crane* case only one party had a basis for the building, namely, the mortgagor. The mortgagee had no cost or basis for the building inasmuch as it did not pay for the building, but merely relied on a personal obligation for the return of the money, secured by a mortgage on the building.

In the case at bar, two parties have a basis for certain deductions with respect to the building. The lessee can charge off, as rent deductions, under Section 23(a)(1)(A), Internal Revenue Code, the cost of the building over its life, inasmuch as it paid, as rental for the building, a cash rent plus the cost of making an improvement which became the lessor's property. Petitioner, under Section 113(a)(5), in effect, paid for the building through the payment of the Federal estate tax based on a large value for the devisor's interest in the building, and can depreciate such value over the life of the building. Therefore, the attempted distinction of the *Crane* case is invalid.

[3] The decision of the court below is contrary to the applicable statute and regulation involved and will lead

to confusion and serious difficulty in the administration of the income tax law.

All lessors necessarily give possession of property to lessees, but such fact has never been considered as depriving the property of value to the lessor. Section 113(a)(5) of the Internal Revenue Code makes no distinction between the case where the lessor paid for the building, leased it, and then devised it to heirs, and the case, such as the one at bar, where the lessee paid for the building, but it became the property of the lessor, who died and devised it to heirs. In the first case (where the lessor paid for the building) the respondent, as a matter of course, allows the heirs to depreciate the building on its value at date of death. The nature of the interest inherited by the heir is precisely the same in both situations, and, if that inherited interest is of such a nature as to warrant depreciation under Sections 113 (a)(5), 114 (a) and 23(1) in one case, it must likewise be allowed in the other.

The applicable regulation, Regulations 111, Section 29.113(a)(5)(1), likewise deals specifically with the basis of inherited property. It contains nothing indicating that the basis thereof should be effected by the question of who erected the improvement thereon, and specifically provides that the fact that possession is postponed shall have no effect whatsoever on the heir's basis therefor. It provides in part as follows:

> "The purpose of the Internal Revenue Code, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect to such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have

been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the *possession* or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is complete, or until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of the property reflected in a sale or other disposition which Section 113(a)(5) recognizes as the measure of gain or loss." (Emphasis supplied.)

The Regulation further provides:

"* * * Since, under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, *residual*, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent. * * *" (Emphasis supplied.)

This Regulation, which the lower court did not discuss or attempt to hold invalid, and which is presumed to be valid, clearly upholds the petitioner's contention that the value of the building as of the date of her devisor's death should not be reduced because of the fact that the lessee had *possession* under the lease, or that petitioner had but a residual or reversionary interest in the possession of the building.

This Regulation, until declared invalid, has the force and effect of law, and hence the lower court's decision

is directly in conflict with the applicable Federal law. (*Brewster v. Gage,* 280 U. S. 327.) Said Regulation has been in effect since October 26, 1943, since which time the Internal Revenue Code has been amended almost yearly, with no change in Section 113(a)(5). This indicates legislative approval of the interpretation of the statute given by the Regulation. (*National Lead Co. v. United States,* 252 U. S. 140.) The fact that the Regulation has not been changed since its issuance entitles it to great weight. (*Lykes v. United States,* 343 U. S. 118.)

The decision of the court below not only expands the applicable statute and regulation by superimposing thereon a special rule for cases in which the lessee rather than the lessor has erected an improvement, but also will lead to considerable confusion and difficulty of administration in the income tax law.

In the first place, if it is sound as to devisees, it must be equally sound as to purchasers, and will therefore operate to deny depreciation on the building to the purchaser of the lessor's interest therein where a lessee has erected the building. Every day in this country, real estate is being sold subject to a lease, and the purchaser is expecting to claim depreciation on the improvements. Thus, if the decision below stands, title companies will be required to expand their processes to insure that the seller or his assignors rather than the lessee or his assignors, erected the improvements on the property. The problem will become particularly complex in the situation which frequently occurs where the lease is executed at a time when a building is already on the premises but permits the lessee to remodel or erect improvements at his own expense.

Again, if the conclusion of the court below is sound that an assignee of property subject to a long term lease obtains no depreciable *interest* in improvements on premises erected by a lessee because he merely acquires the right to occupy the improvements at the termination of the lease, which right is worth zero at the time of acquisition, the same theory must logically be applied to short term leases to deny said assignee depreciation during the term of the lease. This must follow because, under the theory of the court below, a right to occupy the improvement a few years hence does not depreciate during the period of postponement, and thus, there is involved no depreciating asset until the assignee is entitled to possession of the improvement.

When the above problems are considered, one can well understand why Congress provided by statute, and the Commissioner by regulation for a uniform basis at death, unaffected by the question of the source of the improvements involved.

The court below quoted at length from the decision of the Eighth Circuit Court of Appeals in *First National Bank of Kansas City v. Nee,* 190 F. 2d 61 (C. C. A. 8th). That case, while distinguishable from the instant one in many important aspects including the fact that the lessor there did not become the owner of the building until the end of the lease, did make some effort to justify its conclusion under the terms of the tax statute. The theory there adopted wsa that the building erected by the lessee was not held by the heirs of the lessor *for the production of income to those heirs* and was, therefore, not depreciable by them under Section 23(1)(2) of the Internal Revenue Code. That subsection permits depreciation on

"property held for the production of income." Certainly, this decision represents a very strained construction of this phrase. It was obviously intended by Congress to identify property of a business or income-producing nature as distinguished from a personal residence or hobby property. In the instant case, it must be conceded that petitioner's devisor, prior to her death, and petitioner after her devisor's death, owned and held legal title to the building. It was held by them for the production of income, and for no other purpose. Again, if it was not held for the production of income, then expenses in connection therewith by petitioner or her devisor would not be deductible under Section 23(a)(2). That would be a ridiculous result, and certainly not one intended by Congress. Furthermore, the theory of the Eighth Circuit would again produce the same confusion and difficulty of administration outlined above in discussing the theory of the court below and its effect upon the administration of the tax laws.

However, even if we were to concede that petitioner's devisor did not hold the building for the production of income, petitioner, just as any purchaser, certainly held it for that purpose. To the extent the opinion of the court below might be considered to have adopted the Eighth Circuit's view that petitioner did not hold the building for the production of income, it is contrary to the decision of the United States Court of Appeals for the First Circuit in *Reynolds v. Commissioner,* 155 F. 2d 621, and to the decision of the United States Court of Appeals for the Fifth Circuit in *Campbell v. Walker,* decided February 9, 1953, not yet reported, paragraph 72, 822, 1953 Prentice-Hall Federal Tax Service.

In the *Reynolds* case, the taxpayer had inherited valuable jewelry from his aunt, and sold some of it for less than the value at date of her death. He claimed, before the Tax Court, a loss incurred in a sale of "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." The Commissioner contended that, since the jewelry was a personal (non-business) asset when held by the decedent, the ownership and sale by the heir was not a transaction entered into for profit and no part of the loss was deductible. The Tax Court adopted the middle ground and held that it was a capital loss on a transaction entered into for profit. On appeal, the Court of Appeals affirmed, thus approving the principle that the purpose for which an asset is held changes with the death of the owner. The cases show that a personal asset, such as a home, a yacht, or jewelry, becomes a business asset, one held for profit, when inherited by an heir who does not use it as a personal asset.

The Commissioner has acquiesced in decisions of the Tax Court to the same effect:

N. Stuart Campbell, 5 T. C. 272, acq. 1946-1 C. B. 1;

Estelle G. Marx, 5 T. C. 173, acq. 1946-1 C. B. 1; see to the same effect I. T. 3776, 1946-1 C. B. 65.

In *Campbell v. Walker, supra,* the Court held that a business loan changed to a non-business loan after the death of the husband, who had carried on a business, where the wife-legatee discontinued the business operation.

Petitioner inherited a half interest in the land *and building,* and held them both for the production of in-

come for her. Hence, though her devisor may have merely rented the *land* only, for the production of income, petitioner is in a different position, as she inherited the land and building together, as rental property.

4. The lower court has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

In the Tax Court, the witnesses for both parties testified that they had considered the lease and sublease on this property, and that a half interest in the building had a value (average of all witnesses), as of November 3, 1938, of $815,275.00. There was no testimony as to the then value of the building as of the end of the lease. (At the time of the trial (June, 1949) [Tr. 3], the respondent was following its acquiescence in the *Currier* case.) This point was not raised at the trial [Tr. 93-103, 104-326], and only briefly in the respondent's Tax Court Brief. The Tax Court did not find the value of the building as of the end of the lease.

The court below, upon this state of the record, held that the value of the building, as of November 3, 1938, subject to the lease, was zero.

The determination of the value of the building, as of November 3, 1938, is a question of fact or a mixed question of fact and law. If the lower court had determined that the Tax Court had fixed the value of the building, as of November 3, 1938, upon erroneous legal conclusions, the Appellate Court should have sent the case back to the Tax Court for determination of the value, using the correct legal concepts. When the court below made a finding of fact that the building, subject to the lease, had no value as of November 3, 1938, it exceeded its appel-

late powers. The court below in *Belridge Oil Co. v. Commissioner,* 85 F. 2d 762, 768, declared that it is not within the province of the Court of Appeals to make findings of fact on value. That principle of law is in consonance with the principles established by other Courts of Appeals. (*Bonwit Teller & Company v. Commissioner,* 53 F. 2d 381 (C. C. A. 2nd).) In the latter case, the Court held that it was beyond the power of a court to find an arbitrary valuation figure unsupported by evidence. To the same effect is *Pittsburgh Hotel Company v. Commissioner,* 43 F. 2d 345 (C. C. A. 3rd); *Boggs & Buhl v. Commissioner,* 34 F. 2d 859; *Dempster Mill Manufacturing Co. v. Burnet,* 46 F. 2d 604 (App. D. C.).

Both the taxpayer's witnesses and the Commissioner's witnesses testified that the building had a value as of November 3, 1938. The Commissioner's witnesses testified that in placing a value on the building, they took the lease into consideration. [Tr. 265, 305.]

The court below has not indicated that it has any personal knowledge of the value of the Barker Bros. land, building or lease, as of November 3, 1938.

The sublease terminates at December 31, 1960, and there was evidence introduced that the lessee might assign the lease to a straw man at that time (which it could do without further liability to itself or to the straw man.) [Ex. 2-B, p. 2, par. 1; Exs. 7-G, 1-A, 15.] If that happened, taxpayer would get back the possession of the building, which would have considerable value, since it would have a remaining useful life of fifteen years.

The court below, without showing it had personal knowledge of the elements in this case, and without any

evidence having been introduced on this point, said that, capitalizing the rentals at 8 per cent, the entire value of $1,533,100.00 might be in the land alone. [Tr. 353.] This suggestion ignored the testimony of witnesses for both parties that the land was worth, on the average, $458,750.00, and that the lease called for much higher rent than could have been obtained for the land and building, as of November 3, 1938 [Tr. 114, 115, 116, 203, 306, 317, 318], and hence was of great value over and above the value of the unleased land and building. In fact, the highest value placed on the land by any of the Commissioner's witnesses was $750,000.00. [Tr. 305, 306.] This witness, Frisbie, admitted that the unleased land was worth only $375,000.00. [Tr. 318.]

On page 356 of the transcript, the court below followed the respondent's argument, not based on any testimony in the case, that petitioner could not have sold her interest in the building, apart from the land or rentals, and hence the value of her interest in the building is zero.

The court below does not apply the same test to the land, but petitioner suggests that she could not on November 3, 1938, have sold her interest in the land apart from the building and lease, since the buyer could not derive any value from that land until the year 2023 or for 85 years. This suggestion appears reasonable, even though at the end of 2023 the land might have a rental value in a substantial amount, even if it were unimproved. The discount factor alone for 85 years would reduce the present worth to approximately zero. The present worth of a dollar at the end of 85 years, using an 8 per cent interest rate, equals $.0014420515. Ten Place Interest and Annuity Tables, Kent, McGraw-Hill, page 71. On $458,750.00 the present value would be $661.54.

On this state of the facts then, if the building had no value, subject to the lease, the land also had no value subject to the lease, and the entire $1,533,100.00 should be allocated to the lease. But the actual value of the lease is somewhat speculative due to the fact that it could, in effect, be assigned at the end of 1960 without further liability to the lessee or assignee. Furthermore, the lease did not require the lessee or sublessee to replace the building [Ex. 1-A] which will become worthless at the end of 1975, so that, if the lease is not dropped at the end of 1960, it may be dropped by the end of 1975. Under this state of the facts, it is unrealistic to say that the entire value is in the lease, and that there is no value in the building. If the lease were cancelled at the end of 1960, the building would have a considerable value, inasmuch as it would still have a remaining useful life of 15 years. The value as of November 3, 1938, of the right to recover the possession of the building on January 1, 1961, would be substantial. The lower court committed grave error when it made a finding that the building, subject to the lease, had no value.

Conclusion.

Wherefore, it is respectfully submitted that this Petition for a Writ of Certiorari should be granted.

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ELMO H. CONLEY,
Counsel for Petitioner.

BERT A. LEWIS,
Of Counsel.

APPENDIX.

Statutes and Regulations Involved.

INTERNAL REVENUE CODE:

Section 23(1) Depreciation.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(2) of property held for the production of income.

Section 113(a) Basis (unadjusted) of property.—The basis of property shall be the cost of such property; except that—

* * * * * * * * *

(5) Property transmitted at death.—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

Section 114(a) Basis for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

REGULATIONS:

Reg. 111, Sec. 29.113(a)(5)-1 Basis of property acquired by bequest, devise, or inheritance.—(a) Property included.—Section 113(a)(5) applies—

(1) to all property passing from a decedent by his will or under the law governing the descent and distribution of property of decedents;

* * * * * * * * *

(1) General rule.—Except as prescribed in paragraphs (2) and (3) of this subsection the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the fair market value at the time of such acquisition. Since, under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who taks the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent. For example, if distribution of personal property left by a decedent is not made until one year after his death, the basis of such property in the hands of the legatee is its fair market value at the time when the decedent died, and not when the legatee actually received the property; or, if the bequest is of the residue to trustees in trust, and the executors do not distribute the residue to such trustees until five years after the death of the decedent, the basis of each piece of property left by the decedent and thus received, in the hands of the trustees, is its fair market value at the time when the decedent dies; or, if the bequest is to trustees in trust to pay to A during his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A's death the property is distributed to the taxpayer as the sole survivor,

the basis of such property, in the hands of the taxpayer, is its fair market value at the time when the decedent died.

The purpose of the Internal Revenue Code, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113(a)(5) recognizes as the measure of gain or loss.

Reg. 111, Sec. 29.23(1)(4) Capital sum recoverable through depreciation allowances.—The capital sum to be replaced by depreciation allowance is the cost or other basis of the property in respect of which the allowance is made. (See Sections 113(a) and 114.) * * * In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and non-depreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which

bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time.

CALIFORNIA CIVIL CODE:

Section 658. Real or Immovable.—Real or immovable property consists of:

1. Land;
2. That which is affixed to land;
3. That which is incidental or appurtenant to land;
4. That which is immovable by law; except that for the purposes of sale, emblements, industrial growing crops and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale, shall be treated as goods and be governed by the provisions of the title of this code regulating the sales of goods.

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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 537

MARY YOUNG MOORE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 60-70) are reported at 15 T.C. 906. The opinion of the Court of Appeals (R. 343-372) is reported at 207 F. 2d 265.

JURISDICTION

The judgment of the Court of Appeals was entered on September 21, 1953. (R. 373.) A petition for rehearing, filed on October 21, 1953, was denied

on November 5, 1953. (R. 374.) The petition for a writ of certiorari was filed on January 15, 1954. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether taxpayer, the heir of a lessor of land, is entitled to depreciation deductions under Section 23(l) of the Internal Revenue Code with respect to a building erected at the lessee's expense and having a useful life shorter than the term of the lease.[1]

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra,* pp. 12-15.

STATEMENT

The Tax Court's findings of fact (R. 60-63), as amended (R. 71), may be summarized as follows:

The taxpayer and her mother, Mary C. Young, were tenants in common of certain land located in the downtown area of Los Angeles, California. On October 1, 1924, they entered into a 99-year lease of the property for the period from October 1, 1924, to September 30, 2023. The lessee of the property was Sun Realty Company which agreed

[1] In addition to holding that the taxpayer did not have a depreciable interest in the building, the Court of Appeals held that the taxpayer did have an amortizable interest in the "premium" value, if any existed, of the favorable lease. With respect to the latter issue the taxpayer's petition raises certain subsidiary questions (Nos. 2 and 3, pp. 2-3) but contains no discussion of these questions under reasons for granting the writ. A discussion of the amortization issue is contained in a conditional cross-petition which is being filed on behalf of the Commissioner. See pp. 10-11, *infra.*

to pay a rental of $10,000 per month until June 30, 1926, and $20,000 per month from that time until the expiration of the lease. It further agreed to pay taxes, levies, and all other charges on the property, to remove the buildings then standing on the land, and, at its own expense, to construct a building costing not less than $2,000,000. (R. 60-61.)

On October 30, 1924, Sun Realty Company entered into a sub-lease until December 31, 1960, with Barker Brothers, Incorporated, of Delaware, which sub-lease was known to the lessors at the time the lease was signed and was even referred to in the lease. For convenience, certain immaterial changes in identity in the lessee and sub-lessee may be ignored. (R. 61.)

The lessee demolished the buildings previously erected by the taxpayer and her mother. It constructed, at its own cost and expense, an 11-story building, known as the Barker Brothers building. The building, which was erected at a cost of $2,132,000, was completed by January 1, 1926, and was standing on the property on November 3, 1938. (R. 61-62.) On December 7, 1934, the taxpayer and her mother entered into an agreement with the lessee and sub-lessee for a readjustment of the rentals from a fixed sum to a percentage of sales. (R. 62.)

The taxpayer's mother died on November 3, 1938, and her interest in the property passed to the taxpayer. The mother's half interest in the property was evaluated for estate tax purposes at

$1,533,100, this representing a compromise figure between the Government and the estate of the taxpayer's mother. It was also stipulated, for the purpose of this case, that $1,533,100 represented the value of the one-half interest in the property on November 3, 1938. (R. 62.)

The Tax Court found that the fair market value of a half interest in the Barker Brothers building was $800,000 on November 3, 1938. It was found that the building had a 50-year life from January 1, 1926. (R. 62-63, 71.)

The Tax Court, upholding, in part, the taxpayer's contentions, held that the taxpayer was entitled to annual deductions for depreciation with respect to the Barker Brothers building, her basis for depreciation being the $800,000 fair market value of a half interest in the building. It rejected, however, the taxpayer's further contentions that she was entitled to a greater basis for depreciation because of the existence of the lease, and that she was entitled to amortize the supposed value of the lease of the property which she inherited. (R. 63-70.)

Reversing the decision of the Tax Court, the Court of Appeals held that the taxpayer did not have a depreciable interest in the building, but that, if the lease had a "premium" value which was subject to exhaustion, to that extent the taxpayer had an amortizable interest in the lease which would entitle her to annual deductions over the remaining term of the lease. Accordingly, the cause was ordered remanded to the Tax Court for findings as to what extent, if any,

the lease had a "premium" value, and whether such "premium" value was subject to ultimate exhaustion. (R. 343-373.)

ARGUMENT

The question presented by taxpayer's petition is the same as that involved in *Commissioner* v. *Pearson,* 188 F. 2d 72 (C. A. 5th), certiorari denied, 342 U. S. 861. Further review by this Court is, we submit, no more warranted here than it was there.

The right to "depreciation" deductions in computing taxable income is granted by Section 23(l) of the Internal Revenue Code (Appendix, *infra,* p. 12), which authorizes deduction of a reasonable allowance "for the exhaustion, wear and tear" of property used in the taxpayer's business or held for the production of income. The purpose of the allowance, as explained in the applicable Treasury Regulations (Section 29.23(l)-1 of Treasury Regulations 111, Appendix, *infra,* p. 14), is to permit the taxpayer to set aside each year an amount which will "at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113." See also Section 29.23(l)-2 of Treasury Regulations 111 (Appendix, *infra,* pp. 14-15). The "basis" for computing the amount of depreciation deductible annually is the "cost" of the property or, in the case of a taxpayer who acquired it by inheritance, the "fair market value" at the time of its acquisition. Sections 113(a)(5) and 114(a) of the Internal Revenue Code (Appendix, *infra,* pp. 12-13). However, as the Court of Appeals pointed out in the instant case (R. 350), for depreciation

purposes the "basis" provisions of the statute are not reached unless the taxpayer claiming the deduction possesses a depreciable interest in the property in respect to which the depreciation is claimed. *First Nat. Bank of Kansas City* v. *Nee*, 190 F. 2d 61 (C. A. 8th).

1. The court below correctly held that taxpayer, the heir of a lessor of land (a non-depreciable asset), possessed no depreciable interest in a building (a depreciable asset) which was erected at the lessee's expense and had a useful life shorter than the term of the lease. It is well established that only one who suffers an economic loss from the depreciation of property possesses a depreciable interest in it for tax purposes, irrespective of who has the legal title. *Helvering* v. *Lazarus & Co.*, 308 U. S. 252; *Duffy* v. *Central R. R.*, 268 U. S. 55. In this case, the decedent-lessor admittedly had no depreciable interest in the building while she lived.[2] She suffered no economic loss by reason of the depreciation of the building since it had cost her nothing and she had no present right to possess it before the period of its useful life had expired; she had a fee interest in the land subject to an outstanding lease, with the right to receive the ground rent, an interest not subject to depreciation. *Commissioner* v. *Pearson, supra; First Nat. Bank of Kansas City* v. *Nee, supra; Friend* v. *Commis-*

[2] To her the building erected by the lessee represented, at the most, potential income from the property if the lease should be prematurely terminated. *Helvering* v. *Brunn*, 309 U.S. 461. It is also undisputed that the taxpayer herself was not and is not entitled to depreciation deductions with respect to her original, one-half interest as co-lessor.

sioner, 119 F. 2d 959 (C. A. 7th), certiorari denied, 314 U. S. 673; *Reisinger* v. *Commissioner,* 144 F. 2d 475 (C. A. 2d). The entire depreciable interest in the building resided in the lessee who had paid for it and who had the right to possess it during its entire useful life. Section 29.23(a)-10 of Treasury Regulations 111 (Appendix, *infra,* pp. 13-14). Under the circumstances, having had no depreciable interest in the building during her lifetime, the decedent-lessor transmitted none to taxpayer upon her death.[3] After the decedent-lessor's death, as before, the depreciable interest in the building remained in the lessee, who continued to suffer the economic loss resulting from its deterioration. The depreciable interest, and the concomitant right to depreciation deductions, did not shift from the lessee to the lessor's heir (taxpayer) by virtue of the lessor's death. *Commissioner* v. *Pearson, supra; First Nat. Bank of Kansas City* v. *Nee, supra; Friend* v. *Commissioner, supra.*

Contending that the decision of the court below is contrary to the applicable statute and regulations, the taxpayer apparently deems significant the fact that the "basis" provisions of Section 113(a)(5) of the Internal Revenue Code and the corresponding Regulations make no distinction between depreciable and non-depreciable interests in property. (Pet. 10-13.) The contention is with-

[3] The interest which the decedent-lessor did actually transmit to the taxpayer was described by both the Court of Appeals and the Tax Court as follows (R. 70, 348):

> What petitioner inherited from her mother was an undivided half interest in the land under the Barker Bros. building and a reversionary interest in the building.

out merit—the lack of such distinction in the "basis" provisions of the statute and regulations being readily understandable when it is borne in mind, as previously mentioned, that for depreciation purposes the "basis" provisions are not reached unless the taxpayer claiming the deductions possesses a depreciable interest in the property in respect to which the depreciation is claimed.

Equally without merit is the taxpayer's contention (Pet. 10-11) that the decision of the court below will lead to confusion and serious difficulty in the administration of the income tax law. Contrary to the taxpayer's suggestion (Pet. 13), there is no need for title companies to be concerned with the question whether vendors of improved realty have depreciable interest in the improvements since, as heretofore indicated, the presence or absence of a depreciable interest depends not upon whether a person has title to property but rather upon whether he suffers an economic loss by reason of its deterioration. The analogy which the taxpayer attempts to draw between the building in the instant case and a building erected at the expense of a lessee and subject to only a short-term lease (Pet. 14) would be apt only if the nature of the latter building were such that it had a useful life shorter than the term of the short-term lease. The taxpayer's assertion that she inherited a building which she held for the production of income (Pet. 16-17) loses sight of the crucial fact that in so far as the building, as distinguished from the land with the ground rent, is concerned, she inherited only the right to future possession after

the expiration of the building's useful life. The Court of Appeals did not err, as taxpayer contends (Pet. 17-20), in concluding that no value could properly be attributed to such an empty right.[4]

2. The decision below is not in conflict with any decision of this Court or any of the Courts of Appeals. *Crane* v. *Commissioner,* 331 U. S. 1, which the taxpayer asserts is in conflict (Pet. 9-10), did not present an issue comparable to that here involved. In the *Crane* case, this Court sustained the Commissioner's position that mortgaged property (in which the taxpayer concededly had a depreciable interest) must be valued at its full value, undiminished by the amount of the mortgage, rather than by the value of the "equity" in the property, in determining its basis for depreciation and for gain or loss on its sale. That case did not deal with the problem here, namely, whether a lessor of land (or his successor) acquires a depreciable interest in improvements erected by the lessee and having a useful life shorter than the term of the lease. Appeals were taken in three of the only four cases involving this problem.[5] In those appeals, the Ninth Circuit in the instant case, the Fifth Circuit in the *Pearson* case, *supra,* and the Eight Circuit in the

---

[4] Nor does the record support the taxpayer's implications (Pet. 7, 10) that for estate tax purposes value was assigned to the decedent-lessor's possession of such right. Thus, as the Court of Appeals pointed out (R. 353), in view of the amount of the ground rent, the value placed upon her interest in the property for estate tax purposes may very well have represented the assumed value of the land alone.

[5] The Commissioner did not seek review of the adverse decision of the Tax Court in the earliest case, *Currier* v. *Commissioner,* 7 T.C. 980, with respect to which he has, however, published his non-acquiesence, 1950-2 Cum. Bull. 5.

First Nat. Bank of Kansas City case, *supra*, although emphasizing different reasons for their conclusions, have uniformly held that a taxpayer in these circumstances is not entitled to deductions for depreciation.

3. To permit a lessor of land (or the lessor's heir) to deduct depreciation on account of a building the entire cost of which was incurred by the lessee, and the useful life of which will end before the land reverts to the lessor, would produce the incongruous result that duplicate depreciation deductions could be taken by the lessor and the lessee with respect to the very same property. But in such a case the entire burden of the economic loss, which the statutory allowance for annual depreciation is designed to offset, falls upon the lessee, and it is he alone who is entitled to the deduction. The Treasury Regulations expressly provide that a lessee who erects improvements which have a useful life less than the term of the lease may take annual deductions in "the form of an allowance for depreciation," so as to spread the cost over the useful life of the improvements. Section 29.23(a)-10 of Treasury Regulations 111. The lessee's right to deduct the depreciation of the building over its useful life precludes any notion that the lessor (or the lessor's heir) is entitled to the same deduction.

4. For the foregoing reasons, we believe it plain that no adequate basis exists for granting the petition and that further review of the issue raised by the taxpayer would not be warranted.

If the taxpayer's petition should be granted,

however, the case ought to be considered in its entirety. For that reason, a petition for a writ of certiorari is being filed on behalf of the Commissioner, the granting of which is urged only in the event that the taxpayer's petition should be granted. The Commissioner's conditional petition will seek review of the question whether the Court of Appeals erred in holding that, if the lease had a "premium" value, and if such value was subject to exhaustion, to such extent that value could be amortized and the taxpayer allowed annual deductions over the term of the lease.

CONCLUSION

The decision below with respect to the issue raised by the taxpayer is correct. There is no conflict in decisions, nor is there any other basis for review by this Court. Accordingly, the taxpayer's petition for a writ of certiorari should be denied.

Respectfully submitted,

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FEBRUARY, 1954.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) [As amended by Sec. 121(c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property Transmitted at Death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

(26 U.S.C. 1946 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.23(a)-10. *Rentals.*—If a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. * * * The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improve-

ments made, this deduction shall take the form of an allowance for depreciation.

* * * If, in any case, the life of the improvements is less than the number of years the lease has to run, including the renewal period if properly to be considered, the deduction for depreciation with respect to such improvements shall be spread only over such life.

Sec. 29.23(l)-1. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. * * *

Sec. 29.23(l)-2. *Depreciable Property.*—The necessity for a depreciation allowance arises from the fact that certain property used in the business, or treated under section 29.23(a)-15 as held by the taxpayer for the produc-

tion of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, or to land apart from the improvements or physical development added to it.

* * *

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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

MARY YOUNG MOORE

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

On January 15, 1954, the taxpayer filed a petition for a writ of certiorari in *Mary Young Moore* v. *Commissioner of Internal Revenue,* No. 537, seeking review of those parts of the judgment entered in the case which were unfavorable to the taxpayer. A brief in opposition to this petition is being filed on behalf of the Commissioner setting forth the reasons why the issue raised by the taxpayer does not merit further review.

The Acting Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that, in the event the Court should grant the petition for a writ of certiorari in No. 537, but only in that event, a cross-writ of certiorari should issue to re-

view those portions of the judgment below which were not favorable to the Commissioner of Internal Revenue. The record in No. 537 includes the record upon which this cross-petition is based.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 60-70) are reported at 15 T. C. 906. The opinion of the Court of Appeals (R. 343-372) is reported at 207 F. 2d 265.

JURISDICTION

The judgment of the Court of Appeals was entered on September 21, 1953. (R. 373.) A petition for rehearing, filed by the taxpayer on October 21, 1953, was denied on November 5, 1953. (R. 374.) By order of Mr. Justice Reed, dated December 19, 1953, the time within which the Commissioner of Internal Revenue might file a petition for a writ of certiorari was extended to February 18, 1954. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether taxpayer, upon inheriting a fee interest in land subject to a long-term lease, is entitled under Section 23(l) of the Internal Revenue Code to amortize against current rentals the "premium" value of a lease established on the basis that its terms were more favorable than could have been obtained if the lease had been negotiated at the time of the decedent-lessor's death.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth at pp. 12-15 of the brief for the respondent in opposition in No. 537.

STATEMENT

The pertinent facts in the case are set forth at pp. 2-5 of the brief for the respondent in opposition in No. 537.

REASONS FOR GRANTING THE WRIT

While holding that taxpayer, as the heir of a lessor of land, was not entitled to deduct depreciation with respect to a building erected at the lessee's expense and having a useful life shorter than the term of the lease, the court below also held that, if the lease had a "premium" value which was subject to exhaustion, to that extent the taxpayer had an amortizable interest in the lease which would entitle her to annual deductions over its term. Accordingly, it remanded the case to the Tax Court for determination (1) to what extent, if any, the rents reserved in the lease exceeded any rents which could have been obtained if the lease had been negotiated at the time of the decedent-lessor's death, and (2) whether such favorable feature of the lease, if it existed, was subject to ultimate exhaustion.

The decision of the Court of Appeals with respect to the amortization issue overlooks, we submit, the relationship between the ground rents reserved in the lease and the fee interest in the land, and conflicts directly with the decision of the Court

of Appeals for the Seventh Circuit in *Friend* v. *Commissioner,* 119 F. 2d 959, certiorari denied, 314 U. S. 673, and in principle with the decision of this Court in *Hort* v. *Commissioner,* 313 U. S. 28.

As the heir of a lessor of land, the taxpayer acquired a fee interest in the premises together with the right to receive a specified ground rent over the period of a long-term lease.[1] Of course, an owner's right to lease his property is merely one of the attributes of ownership and rent received is ordinary income from the property. In executing the lease here involved the decedent-lessor and the taxpayer as co-lessor merely substituted for their indefinite right to income from the property the specific rights provided in the lease. While terms of the lease favorable to them may very well have added to the value of their holdings, certainly their right to receive rental income under the lease was merely incident to the fee and has never been separated from it. Cf. *Crane* v. *Commissioner,* 331 U. S. 1, 6. The income-producing property—the land—was not depreciable and the courts have repeatedly held that the mere right to receive income is not subject to an exhaustion allowance even though the right is limited as to years. *Codman* v. *Miles,* 28 F. 2d 823, 824 (C. A. 4th), certiorari denied, 278 U. S. 654; *Brooks* v. *United States,* 6 F. Supp. 844 (C. Cls.); cf. *Roxburghe* v.

[1] We are not here concerned either with the taxpayer's reversionary interest in the building which was constructed by the lessee and had a useful life shorter than the term of the lease or with the sub-lessor's right to greater annual rentals from the sub-lessee.

Burnet, 58 F. 2d 693 (C. A. D. C.), certiorari denied, 286 U. S. 567.

The court below did not hold that the rentals which the taxpayer receives for her original one-half interest in the property (or the rentals which the decedent-lessor would have received if she were still alive) could be reduced by any deduction for exhaustion or depreciation of the leasehold. It held rather, in essence, merely that the interest of the decedent-lessor became capitalized upon her death and that then, for the first time, the rentals attributable to her interest had to be applied against the new capital base, through allowances for depletion or exhaustion, before they could be subject to tax. This holding is contrary to that of the Seventh Circuit in *Friend* v. *Commissioner, supra.* See also: *Peters* v. *Commissioner,* 4 T. C. 1236; *Annex Corp.* v. *Commissioner,* decided May 24, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,256). Moreover, whether future rentals may be capitalized at the time of a decedent-lessor's death for the purpose of determining future gain or loss with respect to the leasehold was considered by this Court in *Hort* v. *Commissioner, supra,* and that decision should be controlling here.

In the *Hort* case, the taxpayer had inherited an office building in 1928 subject to an advantageous long-term lease. In 1933, he was paid a large amount by the tenant for cancellation of the lease. The Government sought to impose a tax upon the amount thus received in 1933. The taxpayer contended that the leasehold became capitalized in

1928, that what he had received in 1933 was simply a return of capital, and indeed that it was less than the amount of the new 1928 basis, with the consequence that he sustained a deductible loss. This Court rejected those contentions and held that no portion of the amount received could be regarded as a return of capital for tax purposes. It was not (p. 31) "a return of capital because petitioner acquired the lease as an incident of the realty devised to him by his father."

Similarly here, no part of the annual rentals can be treated as a return of capital based upon capitalization of the leasehold at the decedent-lessor's death. The rental payments constituted income flowing from and incident to the ownership of the premises, and were properly subjected to income tax.[2]

CONCLUSION

For the reasons stated, but only if the taxpayer's petition for a writ of certiorari should be granted in No. 537, it is urged that this conditional cross-petition for a writ of certiorari be granted in

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[2] The Court of Appeals further erred in remanding this case for a determination of whether any "premium" value attaching to the lease was subject to ultimate exhaustion. Whether the income that will be realized from the land at the expiration of the lease will be more or less than the income specified in the lease cannot be foreseen. It is known only that the land is not subject to exhaustion and will always maintain its income-producing possibilities. While the expiration of the lease in the instant case might, like the cancellation of the lease in the *Hort* case, decrease the value of the realty, the amount of such decrease here, as there, could be ascertained (p. 33) "only when its extent had been fixed by a closed transaction"—namely, sale of the realty.

order that all aspects of these related issues may be reviewed.

Respectfully submitted,

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